Oil and Gas, Natural Resources, and Energy Journal

Volume 7 | Number 1

August 2021

Stop Pushing People into the Pool: How Oklahoma's Forced Pooling Laws Can Better Resemble an Open Market

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VOLUME 7 NUMBER 1

STOP PUSHING PEOPLE INTO THE POOL: HOW OKLAHOMA'S FORCED POOLING LAWS CAN BETTER RESEMBLE AN OPEN MARKET

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I. Introduction

Imagine a man trying to sell his car on the open market. One day he gets a letter in the mail. It is an offer to buy his car. The man laughs and throws away the letter because the price was insultingly low. He soon gets another letter in the mail, this time from the state, notifying him that he will be forced to sell his car at that low price offered by the buyer. The man thinks this must be a joke. He goes to the state and argues that there is no way this is a fair price. The man shows examples of several sales of similar cars going for double the price. On the other hand, the buyer provides evidence of a sale—at the same low price he is offering now—between the buyer and the seller's neighbor. This is the only evidence the state will accept. Because of this evidence, the state forces the sale at the low price.

This scenario makes a mockery of open market transactions. But the forced pooling scheme in Oklahoma does the very same thing with oil and gas leases. The goal of this paper is to provide an overview of the forced pooling laws in Oklahoma and how they can be better. To do this, I will begin with some background information on what forced pooling is through the rest of Section I. In Section II, I will dive into the statutory scheme that

* I want to thank God, Lyndsay Hajek, Scott and Beth Hajek, Tony Weaver, Professor Zachary Schmook, and everyone on the ONE-J editorial board. Without you this article wouldn't have been possible.

sets the foundation for the way forced pooling is handled in Oklahoma, Texas, and other states. Section III will then explain what happens beyond the statutes, particularly discussing the role of the Oklahoma Corporation Commission ("OCC"). This discussion will be the bulk of this comment as it will get into the different ways Oklahoma could improve forced pooling by broadening its fair market valuation method. Section IV will summarize the issues with Oklahoma's forced pooling scheme and how Texas avoids these issues. Before concluding, Section V will discuss how these changes can be made and why they have not.

A. Spacing Units and Voluntary Poolings

To understand the idea of forced pooling, it will help to discuss how the owner of a natural resource is determined. This has changed from the rule of capture to unitization through spacing units. After spacing units are created, multiple owners can come together to drill a well in that unit by voluntarily pooling their interests. But when those owners cannot come to an agreement on their own, the Oklahoma Corporation Commission can force the owners to pool their interests so that an oil well can be drilled.

In the beginning, the rule of capture was the law governing who could claim ownership over natural resources. Resources below the ground generally belonged to the owner of the land above that resource. But when there was a large pool of a resource below two or more different properties, the rule of capture determined ownership. Under the rule of capture, the first person to extract a resource from the ground had the exclusive ownership of that resource.[1] This led to landowners racing to extract resources because whoever got it first was the owner, with the slower landowner being left without compensation for any oil under their property that was extracted by a neighbor.[2] This also meant that many landowners were drilling into the same pool of resources, leading to over-drilling. For example, one pool of oil underground could be large enough to cover several different properties owned by several different people. When several people try to drill into the same pool of oil, there are two primary types of waste that occur: the waste of economic resources and the waste of natural resources.[3] Preventing these sorts of waste and conserving natural

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1. Abby Harder, *Compulsory Pooling Laws: Protecting the Conflicting Rights of Neighboring Landowners*, NCSL (Oct. 24, 2014), https://www.ncsl.org/research/energy/compulsory-pooling-laws-protecting-the-conflicting-rights-of-neighboring-landowners.aspx.

2. *Id*.

3. OIL AND GAS LAND REFERENCE VOLUME 78 (Am. Ass'n of Prof'l Landmen ed., 9th ed. 2012).

resources is a fundamental goal of the statutes establishing the OCC's ability to create spacing units.[4]

Spacing unit laws came in to supersede and to fix some of the issues that rose from the rule of capture. The issues of over-drilling, over-producing, and racing to capture are fixed by requiring a spacing unit to be formed before a well can be drilled.[5] Spacing units are areas of approximately uniform size and shape that are established by the OCC.[6] A unit typically covers an entire "common source of supply," which is typically a pool of oil or a pocket of natural gas under the earth.[7] Only one well can be drilled on these units,[8] thereby eliminating the issue of multiple wells being drilled to extract out of the same source. This also protects neighboring landowners because the OCC will include them in the same unit when their property is above the same common source. For example, take two landowners with two separate pieces of property, each of them setting on top of one common source of oil. Where the rule of capture would have two potential drillers and a race to extraction of the source beneath them, the spacing unit statute now requires that a single spacing unit be created above that source—with both pieces of property being included in that single unit. This ensures that both landowners have a fair opportunity to produce their fair share of oil and gas in the common source of supply in their spacing unit.[9]

In a spacing unit with multiple land or other interest owners, who gets to drill the well? Depending on who the owners are, there are many ways to go about drilling on a spacing unit. If an oil producer and a farmer have interests on the same spacing unit, they will likely come to an agreement where the oil producer drills the well and compensates the farmer with a percentage of the profits from producing the oil in their unit. There are many possible scenarios like this with no limit to the number of owners and the nature of the arrangements.

Underlying these arrangements between parties is an agreement to come together to drill a well by "pooling" their interests. The spacing unit is what allows them to do that. In Oklahoma, the establishment of a spacing unit by the OCC is enough to "perfect" the pooling process so that nothing else needs to be done, whereas in most other states, the owners would need to

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4. *Id.*
5. 52 O.S. § 87.1(e) (OSCN 2021).
6. 52 O.S. § 87.1(a), (e) (OSCN 2021).
7. *Id*. at § 87.1(e).
8. *Id.* There are also exceptions to the one well rule.
9. AM. ASS'N OF PROF'L LANDMEN, *supra* note 3, at 80.

file for a declaration of a pooled unit.[10] The establishment of a spacing unit, along with an agreement between owners to drill a well on their spacing unit is a "voluntary pooling." But people are not always going to come to agreements that easily.

In any other context, when people cannot come to an agreement, they go their separate ways. But in the oil and gas industry, great importance is placed on getting those resources out of the ground. It is so important that if someone wants to drill a well but cannot come to an agreement with the other owners in the spacing unit, they don't have to give up their hopes of producing. They can go to the OCC who has the authority to force the "non-consenting" owners (owners who won't agree to a voluntary pooling) to pool their ownership interests to "avoid the drilling of unnecessary wells, or to protect correlative rights."[11] Forced pooling can also be used when the owner of one or more pieces of land can't be found,[12] but the focus of this comment will be on situations where forced pooling is exercised when known owners do not agree to pool.

B. The Forced Pooling Process in Oklahoma

Forced pooling allows the OCC to pool the interests of parties who have not come to an agreement on their own.[13] When a party is forced to pool, the pooling order not only sets the terms for one well site, but it sets the terms for the entire spacing unit and any well drilled on it.[14] However, this does not happen automatically. An application must be filed by any owner with the right to drill and produce oil and gas in the unit,[15] such as mineral owners, lease holders, and working-interest owners who wish to pool the other, non-consenting owners.[16] The person who files the application is typically the party who wishes to oversee the drilling of the well (and be responsible for making all the decisions that come with production). To be in charge of production, the owner must be deemed the "operator" by the pooling order. The operator is typically the owner with the largest share of working interest.[17] A working interest simply means that the owner's

10. *Id.* at 78.
11. 52 O.S. § 87.1(e) (OSCN 2021OSCN 2021).
12. AM. ASS'N OF PROF'L LANDMEN, *supra* note 3, at 81.
13. 52 O.S. § 87.1(e) (OSCN 2021OSCN 2021).
14. Amoco Production Co. v. Corp. Comm'n, 1986 OK CIV APP 16, ¶ 24, 751 P.2d 203, 208.
15. 52 O.S. § 87.1(i) (OSCN 2021OSCN 2021).
16. *Id.* at § 87.1(e).
17. Charles Nesbitt, A Primer on Forced Pooling of Oil and Gas Interests in Oklahoma, 50 OKLA. B.J. 648, 653 (1979).

"bundle of sticks" includes the ability to drill a well and produce oil and gas on the property.[18] It often makes sense to allow the majority owner to be the operator because the person who has the most "skin in the game" is more likely to do things the right way to avoid jeopardizing his investment. Another important factor to consider when designating an operator is actual, bona fide exploration activity.[19] This activity must be more than just filing the right paperwork before the other owners. There are several considerations to help the OCC determine whether the proposed operator has actually made an effort to produce. These considerations include looking at when the well was first proposed, whether the proposed operator has drilled other wells, whether any equipment has been leased out, and so on.[20] This is an important factor because the OCC wants to give the keys to the operation to someone who is actually going to follow through and produce oil and gas.

The pooling application must give all owners that the applicants can find through due diligence at least fifteen days' notice. This notice must be by mail, by publication in Oklahoma County, and by publication in a newspaper in each county where the lands in consideration for pooling are located.[21] After notice and a hearing in front of the OCC, an order may be made by the OCC pooling the interests in accord with terms and conditions that are reasonable and that allow the owner being forced into the pooling a chance to receive their fair share of the oil and gas being extracted.[22] This ability by the OCC to force mineral owners to pool their interests to conserve natural resources has been recognized by the Oklahoma Supreme Court as a valid exercise of state police power.[23]

II. Statutory Scheme

A. How Other States Approach Forced Pooling

Most states in the U.S. have some form of a forced pooling statute (only nineteen states have no forced pooling statute whatsoever), but not all states create the same outcome for non-consenting owners. The different statutes can be distinguished by looking at the consequence imposed on non-

18. 52 O.S. § 570.2(12) (OSCN 2021).
19. Nesbitt, *supra* note 17.
20. *Id*.
21. *Id*.
22. 52 O.S. § 87.1(e) (OSCN 2021).
23. Anderson v. Corp. Comm'n, 1957 OK 39, ¶ 11, 327 P.2d 699, 702; Wakefield v. State of Oklahoma, 1957 OK 10, ¶ 6, 306 P.2d 305, 307.

consenting owners. There are three basic categories: the "risk-penalty" approach, the "costs-only" approach, and the "options-given" approach.

The most common approach is the "risk-penalty" approach. This approach forces those owners who cannot come to an agreement to compensate the producing owners for the risk and cost of production.[24] The justification behind this approach is that if owners don't participate, they will be penalized for making those producing owners bear that risk on their own. At first glance this could seem unfair: why should an owner be penalized and forced to pay someone for taking a risk when the owner wants to play it safe and avoid that risk? But when viewed through a conservationist lens, it makes total sense. Most pooling statutes want to promote oil and gas exploration, protect the right of owners to drill, and prevent waste. By forcing someone to pay a potentially large penalty for not participating, the risk-penalty approach not only ensures that these objectives will be met, but it also encourages owners to come to a voluntary pooling agreement and avoid forced pooling altogether.[25]

The risk-penalty approach is used by most large oil-producing states. Texas, North Dakota, New Mexico, and Colorado—the first, second, third, and fifth largest oil producing states in the U.S.[26] respectively—all have some sort of risk-penalty approach in their statutes. In Texas, for example, any non-consenting owner who is force-pooled and elects not to pay a proportionate share of the costs of operation and production in advance will be responsible for reimbursing the producing owner. This reimbursement of production costs comes out of the non-consenting owner's share of production revenues. And on top of that, they will pay a fee of up to 100 percent of their share of the production costs, essentially doubling the price they'd have to pay.[27] North Dakota makes non-consenting owners pay a risk penalty of 50-200 percent, depending on whether they have agreed to lease their mineral rights.[28] New Mexico similarly requires non-consenting owners to pay their share of production costs plus a risk-penalty of up to 200 percent of these costs.[29] Colorado is a bit steeper on the penalty imposed to non-consenting owners. These penalties are 100 percent of the

24. Harder, *supra* note 1.

25. *Id.*

26. Oklahoma is number 4. *Oil and Petroleum Products Explained: Where Our Oil Comes From*, EIA (last updated Oct. 26, 2020), https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php.

27. TEX. NATURAL RESOURCES CODE § 102.052(a) (2020).

28. N.D. CENT. CODE, § 38-08-08(3)(a)-(b) (2020).

29. N.M. STAT. ANN. § 70-2-17(c) (2020).

non-consenting owner's share of the cost of surface equipment and operation of the wells, along with 200 percent of the portion of costs and expenses for preparation of drilling.[30] Overall, the risk-penalty approach encourages the voluntary pooling by owners because, as noted above, the penalties can be more expensive than if they had come to an agreement in the first place. This method is, however, more favorable to extraction companies as it gives would-be, non-consenting owners almost no choice but to come to an agreement with the extracting companies.

Another approach used by some states (but only one top-ten oil producing state—Alaska[31]) is the "costs-only" approach, which requires non-consenting owners to be liable only for production costs if the extraction is successful.[32] This is like risk-penalty, without the penalty. The non-consenting owner still must pay for production costs, but there is no additional penalty for avoiding the risk that the other landowners are taking by producing. Alaska also, uniquely, allows for a landowner to drill for just their proportional amount of oil and gas on their individual piece of land if a voluntary pooling cannot be reached.[33]

Finally, the third approach—which Oklahoma uses—is called the "options-given" approach. Here, non-consenting owners can choose from a set list of options that fit their circumstances best, and there is usually an automatic option if the non-consenting party does not choose in time.[34] This scheme is said to be the best solution for a free-market approach by allowing owners to choose what would best benefit them.[35] But this approach also discourages voluntary pooling because even if they are subject to a pooling order, there isn't a known, mandatory punishment that comes with it, like under the risk-penalty approach. Instead, non-consenting owners are willing to ride out the pooling order to see what options they get.

B. Oklahoma's "Options-Given" Approach

In Oklahoma, someone subject to a pooling order can either lease their rights to the applicants or choose to participate in the operation.[36] Leasing their rights to the applicants is typically done in exchange for a royalty,

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30. COLO. REV. STAT. § 34-60-116(7)(b)(I)-(II) (2020).
31. ALASKA STAT. § 31.05.100(c) (2020).
32. Harder, *supra* note 1.
33. ALASKA STAT. § 31.05.100(e) (2020).
34. Harder, *supra* note 1.
35. *Id.*
36. 52 O.S. § 87.1(e) (OSCN 2021).

which is an agreed upon rate (usually a percentage of the production of the well) that an oil company pays a landowner to use their land and minerals. Along with a royalty payment, the landowner also usually gets an upfront payment, referred to as a "lease bonus," from the producer. As the royalty goes up, the bonus goes down and vice versa. Going this route leases the owner's rights away and avoids participation in exchange for a small fee. Participating, in contrast, allows owners to keep their rights, but the costs of drilling are split with the producer. Choosing to participate gives owners the potential to earn more than they would with only a royalty interest.[37]

It is important to note that once an option is selected, the owner being pooled is stuck with that option.[38] An owner being pooled is not able to choose to lease away their rights and then, after seeing that the production is successful, opt in to participate in the other wells on that unit. Even if the operator of the unit fails to pay a royalty owner who had leased the operator their rights, the owner is now in a debtor-creditor relationship. This failure to pay is not justification to retroactively choose to participate in the well.[39] Depending on how successful the well is, participation could lead to a higher compensation, especially if more wells are drilled. But the statute currently forces owners to take a gamble on whether they think any wells in the unit will be successful enough to justify participation in the well. To avoid the gamble, the ability to lease away rights seems like a fair second option. But it will become clear that this option is not always ideal either.[40]

When looking at the top ten oil-producing states in the United States, Oklahoma is the only state to utilize the "options-given" approach.[41] California[42] has no forced pooling law at all.[43] Alaska[44] uses the "costs-only" approach, and the other seven states all use the "risk-penalty" approach.[45] Oklahoma is the only one of the top five oil-producing states to not use the risk-penalty approach.

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37. *Id.*
38. Amoco, 1986 OK CIV APP 16, ¶ 24.
39. Buttram Energies, Inc. v. Corp. Comm'n, 1981 OK 59, ¶¶ 5, 7, 629 P.2d 1252, 1254.
40. *See infra* Section III(C).
41. Harder, *supra* note 1.
42. California is the seventh largest oil and gas producing state in the United States. *Oil and Petroleum Products Explained: Where Our Oil Comes From*, *supra* note 30.
43. Harder, *supra* note 1.
44. Alaska is the sixth largest. *Oil and Petroleum Products Explained: Where Our Oil Comes From*, *supra* note 30.
45. Harder, *supra* note 1.

C. The Scope of Forced Pooling Statutes

We can look to Texas, the largest oil and gas producing state in the U.S., and see how its forced pooling laws promote more voluntary pooling. This is not only because it takes a risk-penalty approach,[46] but also because the scope of the statute limits the situations where a forced pooling can occur. Oklahoma's forced pooling scheme is very comprehensive and broad, whereas Texas courts and lawmakers are strongly against forced pooling, leading to a very limited set of pooling statutes.[47] These limited statutes—along with other factors discussed in the next section—are the reason Oklahoma oil producers are much more likely to try to force pool. From 2014 to 2020, the ratio of final pooling orders to completed wells in Oklahoma was 55%.[48] With an average number of pooling orders per year in that span being 667, and completed wells being 1,232.[49] While in Texas, the average number of completed wells per year is 13,937.[50] But while Texas has over ten times the amount of completed wells in that span, Oklahoma's pooling orders in 2020 alone were over twice as many as Texas has had since 1992.[51]

Texas enacted its forced pooling law, the Mineral Interest Pooling Act of 1965 ("MIPA"), to apply in cases where there are small or irregularly shaped tracts of land that are not big enough to cover an oil producing unit by themselves. The Texas Court of Civil Appeals has explained the spirit of the law and the intention of the courts and legislature:

> [W]hen spacing patterns were set by the Railroad Commission in a field, the owner of a tract smaller than such drilling unit either would be denied a permit altogether or would be granted such a low allowable that it was not profitable to drill. His oil, then,

46. The risk-penalty is a harsher result in Texas forced poolings, compared to getting options in Oklahoma. *See supra* Section II(A).

47. AM. ASS'N OF PROF'L LANDMEN, *supra* note 3, at 81.

48. Data extracted from https://oklahoma.gov/occ/divisions/oil-gas/oil-gas-data.html, and from an Open Records Request for pooling data https://oklahoma.gov/occ/news/open-records-requests.html.

49. *Id.*

50. SUMMARY OF DRILLING PERMITS, COMPLETIONS AND PLUGGING REPORTS PROCESSED: 2020 ANNUAL REPORT 1 (R.R. Comm'n of Tex., 2020), *see also* annual reports for 2019, 2016.

51. R.R. Comm'n of Tex., Oil and Gas Proposals for Decision and Orders: Mineral Interest Pooling Act Index, https://www.rrc.state.tx.us/hearings/dockets/oil-gas-proposals-for-decision-and-orders/mineral-interest-pooling-act-index/ (showing a total of 71 orders under MIPA with the oldest being from 1992 and the newest from 2020).

> would be drained away and produced by others. Alternatively, if the small tract owner were granted an allowable which permitted profitable development of his tract he would drain away his neighbor's oil and gas in that he was allowed to produce more oil or gas than was in place under his tract. These problems the Act was designed to cure by providing a method by which the owners of small tracts could be forced to pool their interests into a proration unit of the size provided for the field. The owners may pool by agreement, but in the absence of their being able to agree or unwilling to have their interests pooled, one of their number can make application to the Railroad Commission under the Act and force the others to pool with him.[52]

MIPA only applies to reservoirs discovered after March 8, 1961.[53] This already excludes most reservoirs in Texas because most of them were discovered before March 8, 1961.[54] If the reservoir was discovered after March 8, 1961, three requirements must be met before pooling can be forced: (1) there must be at least two separately owned tracts of land in the unit; (2) there must be separately owned interests in the oil and gas, and the owners must not have agreed to pool their interests; and (3) at least one of the owners must have drilled or have proposed to drill a well on the unit.[55] The three elements above are also mentioned in the Oklahoma forced pooling statute,[56] but there is a key difference. Where Texas requires that there be at least two separately owned tracts of land and separately owned interests, Oklahoma requires at least two separately owned tracts of land or separately owned interests.[57] Imagine a farmer who owns an entire mile section of land. Assume he has leases with four different producers with each producer leasing a quarter of the section. In Oklahoma, one of the producers could file an application and force pool the rest of the owners because there are separately owned interests. In Texas, forced pooling in

52. Superior Oil Co. v. R.R. Comm'n of Texas, 519 S.W.2d 479, 482 (Tex. Civ. App. 1975), writ refused NRE (June 25, 1975).

53. TEX. NAT. RES. CODE ANN. § 102.003 (2020).

54. *See History of Oil Discoveries in Texas*, TEXAS ALMANAC (last visited Dec. 30, 2020), https://texasalmanac.com/topics/business/history-oil-discoveries-texas, *see also Oil Fields in Texas*, WIKIPEDIA (last visited Dec. 30, 2020), https://en.wikipedia.org/wiki/Category:Oil_fields_in_Texas, *see also* https://www.beg.utexas.edu/files/publications/cr/CR1983-Galloway-1_QAe6885.pdf.

55. NAT. RES. § 102.011.

56. 52 O.S. § 87.1(e) (OSCN 2021).

57. *Id.*

this scenario is statutorily prohibited because even though there are separately owned interests, there is only one owner of the one tract of land.

This post-1961 discovery requirement, along with the separately owned tract requirement, statutorily excludes many would-be pooling applications in Texas and is just the first reason why Texas sees more voluntary pooling. The next section explores how Texas further limits forced pooling beyond the statutes. First, it does a better job of ensuring owners make a bona fide attempt to reach an agreement before resorting to forced pooling. Second, it is better able to find the true fair market value owed to owners being forced to pool.

III. Enforcement and Application: Hearing, Evidence, and Fair Market Value

Oklahoma's statutory scheme allows more pooling applications than Texas because of the lack of a discovery requirement and because of the options-given approach. But even so, this number is still larger than it could be because of how the OCC applies these statutes and rules. In this section, I will first discuss how the OCC gets its authority and what that authority is. Then I will discuss how easy it is to show a bona fide effort to reach a voluntary agreement, which is the first reason forced pooling has become almost automatic in Oklahoma. Finally, I will discuss why forced pooling hearings in Oklahoma don't accurately assess the fair market values that non-consenting owners should be awarded at a pooling hearing. This further incentivizes large production companies to make forced pooling their default option, making it that much more automatic.

A. Administrative Law and Who Governs Forced Pooling Hearings

Forced pooling hearings are handled internally by the Oklahoma Corporation Commission. Hearings occur in a court setting completely within its supervision and jurisdiction, conducted and ruled by an Administrative Law Judge under its employ. The Oklahoma Constitution created the Corporation Commission in Article 9, Section 15.[58] Section 18 of Article 9 allows the Corporation Commission to make its own rules, effectively creating a new legislative body, but they are still subject to general laws created by the actual legislature of Oklahoma.[59] The Constitution gives the OCC power to create rules over transportation and transmission companies. Oklahoma statutes allow the OCC to create an Oil

58. O.K. CONST. art. IX, § 15.
59. O.K. CONST. art. IX, § 18.

and Gas Department under its jurisdiction and supervision, thereby extending its jurisdiction to reach the oil and gas industry.[60] The OCC has exclusive statutory jurisdiction and the power to create and enforce rules regarding the conservation of oil and gas and many other activities regarding the exploration, drilling, and production of oil and gas.[61]

The Oklahoma Constitution gives the OCC power to hold its own court proceedings. In these proceedings, the OCC has the authority, like any other court in Oklahoma, to administer oaths, compel attendance of witnesses, compel production of records, enforce compliance, and give penalties.[62] The OCC is authorized by statute to hire Administrative Law Judges who will preside over all hearings that take place under its supervision.[63] However, the OCC is not a court of general jurisdiction and cannot do certain things, like entering money judgments against appellants,[64] but the OCC still has a lot of power in this setting. No other court, besides the Oklahoma Supreme Court, has jurisdiction to review, affirm, reverse, or remand any OCC ruling.[65]

The Oklahoma Supreme Court has recognized that the OCC has broad discretion in performing its statutory duties.[66] There might be a little too much discretion in the way it approaches pooling hearings, but nevertheless, that means there isn't much standing in the way of the OCC making improvements on its own without having to seek permission.

B. Bona Fide Effort to Reach an Agreement

The OCC rules provide each pooling application must show that the applicant "exercised due diligence to locate each respondent and that a bona fide effort was made to reach an agreement with each such respondent."[67] But what constitutes due diligence and a bona fide effort to come to an agreement? Written rules or procedures are lacking in this area, but a presentation put together by the OCC provides some insight.[68] At pooling hearings in Oklahoma, the Administrative Law Judge asks about the due

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60. 17 O.S. §§ 51, 52 (OSCN 2021).

61. 52 O.S § 139(B) (OSCN 2021).

62. O.K. CONST. art. IX, §19.

63. 17 O.S. § 162 (OSCN 2021).

64. Lear Petroleum Corp. v. Seneca Oil Co., 1979 OK 15, ¶ 13, 590 P.2d 670, 672.

65. O.K. CONST. art. IX, § 20.

66. Wakefield v. State of Oklahoma, 1957 OK 10, ¶ 11, 306 P.2d 305, 309.

67. OKLA. ADMIN. CODE § 165:5-7-7(a) (2020).

68. Oklahoma Corporation Commission, The Pooling Process in Oklahoma 8, 14 (last visited Jan. 11, 2021), https://web.archive.org/web/20171031181028/www.occeweb.com/og/The%20Pooling%20Process%20in%20Oklahoma.pdf.

diligence that the applicant used to locate the interest owners, which can be satisfied with as little as a county records search.[69] The standard for showing a bona fide effort to reach a voluntary agreement is similarly low.

To show a bona fide effort to reach an agreement in Oklahoma, "some oil companies simply mail out a lease proposal and don't even include a copy of the oil and gas lease to review."[70] If the owners don't respond, they get put on the pooling application.[71] In Texas, "a fair and reasonable offer to pool voluntarily" must be made by the applicant or the application will be dismissed.[72] These offers must be detailed in the application, and the applicant and non-consenting owner must have negotiated seriously.[73] This is unlike Oklahoma, where the applicant can simply send an offer and file the application before an offer is even rejected.[74]

Showing a fair offer and serious negotiations were made in Texas is a high bar to overcome. There are several guidelines that keep this bar high to encourage voluntary pooling. An offer in Texas must take into consideration all the relevant facts that existed at the time of the offer and that "would be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties."[75] The offer must also be "fair and reasonable from the standpoint of the party being forced pooled."[76] Texas Courts will give benefit to the side of the small owners, as they are usually the parties being pooled.[77] Courts do this because of the legislative history and intent, which seeks to encourage voluntary pooling.[78]

Applicants in Texas give themselves the best chance to show a fair offer was made if they give owners options or various ways to participate. Offers may be deemed unreasonable for many reasons. Some examples would be an offer only to participate when the owner likely does not have the capital to afford participation, or only offering a fair market value lease to an owner who might decline it because they want to develop themselves or

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69. *Id.*
70. *Id.* at 8.
71. *Id.*
72. TEX. NAT. RES. CODE ANN. § 102.013(b) (2020).
73. Benjamin B. Holliday, Overview of Texas' Mineral Interest Pooling Act 23 (last visited Jan. 11, 2021), https://theenergylawgroup.com/wp-content/uploads/2019/11/HELG-MIPA-FINAL.pdf.
74. The Pooling Process in Oklahoma, *supra* note 68 at 8.
75. Carson v. R.R. Comm'n of Tex., 669 S.W.2d 315, 318 (Tex. 1984).
76. Windsor Gas Corp. v. R.R. Comm'n of Tex., 529 S.W.2d 834, 837 (Tex. Civ. App. 1975), dismissed (Jan. 28, 1976), writ granted (Jan. 28, 1976).
77. Holliday, *supra* note 73 at 27.
78. *Id.*

participate.[79] This is because if the applicant only gives the other owner one option, that option could be viewed as unreasonable from the side of the owner being pooled.

This requirement in Texas is generally so difficult to overcome that the parties often just resort to voluntary pooling. Non-consenting owners usually accept fair and reasonable offers because they know that rejecting a genuine, "fair and reasonable offer" will likely result in a forced pooling under Texas law.[80] Similarly, because Texas actually enforces this requirement, would-be pooling applicants know that they would just be wasting their time if they tried to force pool without first truly trying to reach an agreement with other owners.

C. True Market Value and Issues with Evidence

Beyond showing that efforts were made to reach an agreement, there is still the large hurdle of trying to decide what a fair and reasonable offer actually is. The requirement of showing that a bona fide effort was made to reach an agreement acts as a gatekeeper. That gatekeeper in Oklahoma lets in almost any and every attempt to pool, while the gatekeeper in Texas stands strong to ensure as much voluntary pooling happens as possible. But the real driving force that makes the pooling process in Oklahoma so automatic is the lack of a true, fair and reasonable offer being determined at the OCC pooling hearings.

This is not an issue in Texas, because Texas is so stringent about keeping applications out unless a fair and reasonable offer was made in the first place. This results in forced pooling being the exception in Texas. And when it does happen, there won't be an issue in fair market value because of the efforts made to ensure there was a fair offer before the application was even considered. In fact, the Texas forced pooling statute has been "characterized by scholars as a 'compulsory voluntary pooling act,' because a force pooling order will not issue unless the applicant has made a strong effort to secure pooling voluntarily."[81] In this subsection I will begin with a bit of background information on leases, which is what the OCC and the parties to a pooling order are trying to valuate. I will then discuss the evidence that the OCC does and does not allow when determining lease

79. *Id.* at 31.
80. *Id.* at 23.
81. Texas Oil & Gas Docket No. 02697416, 6-7, https://portalvhdskzlfb8q9lqr9.blob.core.windows.net/media/41280/01-0297416-ammonite-pfd.pdf (citing Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.3(B-1) at pg. 12-24.1 (LexisNexis Matthew Bender 2015) (emphasis added).

value and why this approach leads to an unfair market value. Finally, I will discuss another issue with what the OCC does with some of these values once they are determined.

1. Mineral Leases: The Preferred Option

The fair and reasonable offer being disputed is usually the fair market value of the lease being offered to non-consenting owners. That lease is part of Oklahoma's "options-given" approach: specifically, the option not to participate and instead lease rights away. Not only is participation a huge gamble, as discussed in the previous section,[82] but it is also economically infeasible for most owners. This is especially true when the pooling applicant is a large horizontal drilling company. The costs of horizontal drilling, which the owner being pooled would have to pay their share of, are very high. These high costs may not make sense to an ordinary landowner, who owns the minerals and might not have any experience in oil and gas production. But even for a vertical producer, participating does not make sense because horizontal wells usually cost anywhere from 1.5-2.5 times as much as a vertical well.[83] For the remainder of this subsection, the focus will be on the option to lease rights to the applicants because, for most owners being pooled, participation is not a realistic option.

When pooling applicants try to lease an owner's rights, they can be dealing with the landowner, who owns 100 percent of the mineral rights, or they can be dealing with someone who has already secured a lease on those rights. In the first scenario, applicants will have to negotiate a lease from scratch, where they get a certain working interest, and the mineral owner gets a royalty; the two interests together making up the entire 100 percent ownership of the mineral rights. The working interest is typically anywhere from seventy-five percent to eighty-seven and a half percent, with the mineral owner retaining the corresponding remainder as the royalty. For example, the producer keeps eighty percent of the profit and the mineral owners would get the other twenty percent in exchange for letting the producer use their minerals. In the oil and gas industry this would be referred to as a 1/5 royalty with a 4/5 working interest. But more often than not, especially in large, oil-producing states like Oklahoma, pooling applicants are dealing with the second scenario. The pooling applicants are trying to lease minerals that have already been leased by someone else.

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82. *See supra* Section II(B).

83. S.D. JOSHI, COST/BENEFITS OF HORIZONTAL WELLS 2 (Soc'y of Petroleum Eng'rs, 2003).

Rather than negotiating a new lease, they are essentially trying to buy the lease from the party who currently has it.

When pooling applicants try to buy a lease from someone else, the party on the other end of these negotiations is typically another production company. When these producers try to negotiate with another leaseholder, neither party has as much room to negotiate. This is because they are not working with 100 percent of a mineral interest at this point. The current leaseholder likely has already negotiated a deal with the previous mineral owner, so they are only working with that current leaseholder's working interest. For example, if a vertical producer secured a mineral interest from a landowner with the landowner retaining a 1/8 royalty, the producer now only has 7/8 of that mineral interest to bargain with when a horizontal production company comes in to try to pool. If a horizontal producer wants to pool, they will take over this lease so that they now have a 7/8 working interest with the original mineral owner keeping their 1/8 royalty, leaving the vertical producer with no interest in the minerals. The vertical producer gets compensated for handing over their lease with a per acre[84] cash bonus from the horizontal production company.

The only way for the vertical producer to retain an interest in the minerals would be to negotiate a deal where the horizontal producer receives less than what the vertical producer has to offer. For example, if a vertical producer has secured an eighty-five percent working interest with the original mineral owner retaining a fifteen percent royalty, the vertical producer may negotiate a deal where the horizontal producer gets only eighty percent. Thus, the horizontal producer would have an eighty percent working interest, the original mineral owner would still have their fifteen percent royalty, and the vertical producer would keep a five percent "overriding" royalty. Other than this scenario, all a pooled vertical producer can expect to receive is a cash bonus. This background information will be useful when analyzing how leases are valued by the OCC.

2. Determining Fair Market Value of a Mineral Lease in Oklahoma

Non-consenting owners who are force pooled in Oklahoma do not get the correct market value compensation for their leases. In Oklahoma, the fair market value of a force pooled interest is supposed to be "the level at which this interest can be sold, on open-market negotiations, by an owner willing,

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84. The acreage is determined by how many acres the original mineral interest owner owns the rights to.

but not obliged, to sell to a buyer willing, but not obliged, to buy."[85] This seems to be a straight-forward definition, but Oklahoma can do a much better job of approaching valuations that resemble open-market negotiations.

When money or cost issues arise between parties in a pooling dispute, the OCC "shall determine the proper costs after due notice to interested parties and a hearing thereon."[86] This is one of its statutory duties, and according to the Oklahoma Supreme Court, the OCC has broad discretion in performing those duties.[87] Part of performing that duty of determining proper costs includes hearing or choosing not to hear evidence with respect to the value of a lease during a pooling hearing.

The evidence considered at the pooling application hearing has been a subject for debate. In determining the fair market value of a lease, the administrative law judge will consider leases that have been signed within the same unit.[88] For example, consider a unit with five different interest owners. A horizontal drilling company has already secured a lease with four of the five owners, but the fifth won't agree. The horizontal company will then file an application to force pool the noncompliant owner's interests. At the hearing, the drilling company will use those leases already secured within the unit as evidence of a fair market value for the fifth owner. Leases will also be considered outside of the specific unit, but the OCC has limited this to leases made only in the nine surrounding sections.[89] Along with limits on geographical distance, there is also a limit on distance in time, with leases negotiated more than one year prior to the hearing not being allowed into evidence.[90] Only actual leases, not offers, are allowed as evidence, and only arm's length transactions are considered, excluding State or Indian leases.[91]

Horizontal drillers have also been known to come in and trade large blocks of interests with each other at prices much higher than what is being

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85. Miller v. Corp. Comm'n, 1981 OK 55, ¶ 8, 635 P.2d 1006, 1008.

86. 52 O.S. § 87.1(e) (OSCN 2021).

87. Wakefield v. State of Oklahoma, 1957 OK 10, ¶ 11, 306 P.2d 305, 309.

88. The Pooling Process in Oklahoma, *supra* note 68 at 15.

89. *Id.* at 16, *see also* Joe Warren, *Horizontal Forced Pooling in the Vertical Universe*, OEPA (Jul. 1, 2017), https://okenergyproducers.org/horizontal-forced-pooling-in-the-vertical-universe/.

90. *See* OCC Cause CD No. 201904209, 6, https://imaging.occ.ok.gov/AP/CaseFiles/occ30364755.pdf.

91. The Pooling Process in Oklahoma, *supra* note 68 at 16, *see also* Joe Warren, *Horizontal Forced Pooling in the Vertical Universe*, OEPA (Jul. 1, 2017), https://okenergyproducers.org/horizontal-forced-pooling-in-the-vertical-universe/.

offered to the landowners or other interest owners.[92] When these horizontal drillers trade leases among themselves, it usually consists of more than one lease being traded across multiple units. At the pooling hearing, though, these multi-unit trades are not allowed.[93] This excluded evidence leads OCC hearings to result in inaccurate fair market valuations. When the horizontal producers agree to conceal the values of their trades, this further inhibits the OCC's ability to come up with a truly fair market value.[94]

One of the first examples of the geographical limitation on leases was brought to the OCC in 1976. Fred Coogan and Grady Wallace received a pooling application from Arkla Exploration Company regarding a section of land ("Section 19") in Beckham County.[95] At the hearing for the pooling application, there were witnesses who presented testimony to determine the costs of drilling this well and, most importantly for our purposes, to determine a fair-market value of the lease for the mineral interest from Coogan and Wallace. There was testimony that Arkla had acquired leases from other owners in Section 19 for $35 per acre with a 1/8 royalty,[96] and that Arkla had acquired leases "covering a large area in two townships in this area with the highest bonus being paid being $35 per acre with the normal 1/8 royalty."[97] Other testimony included vague references to leases throughout the top six rows of Figure 1 ranging from $35 to $65 in 1974, leases throughout the bottom four rows of Figure 1 going for $25 in the 1950s, and a reference to a $50 lease in 1975 somewhere "to the west of section 19."[98] The only references to specific sections, besides Section 19 (surrounded by a thick box in the bottom row of Figure 1), are indicated in Figure 1. There are five distinct sections and their respective prices mentioned in the hearing order. The two sections showing $35 and $65 were leases signed by a farmer, who testified to that at the hearing.[99] The three sections in Figure 1 that show four different leases (two in 9N 24W

92. Joe Warren, *Horizontal Forced Pooling in the Vertical Universe*, OEPA (Jul. 1, 2017), https://okenergyproducers.org/horizontal-forced-pooling-in-the-vertical-universe/.

93. *See* OCC Cause CD No. 201904209, 6, https://imaging.occ.ok.gov/AP/CaseFiles/occ30364755.pdf.

94. *Id*.

95. OCC Cause CD No. 46342, http://imaging.occeweb.com/AP/Orders/OCC_OG_0LUG4UM_3NL4H8K.pdf.

96. *Id.* Findings ¶ 6.

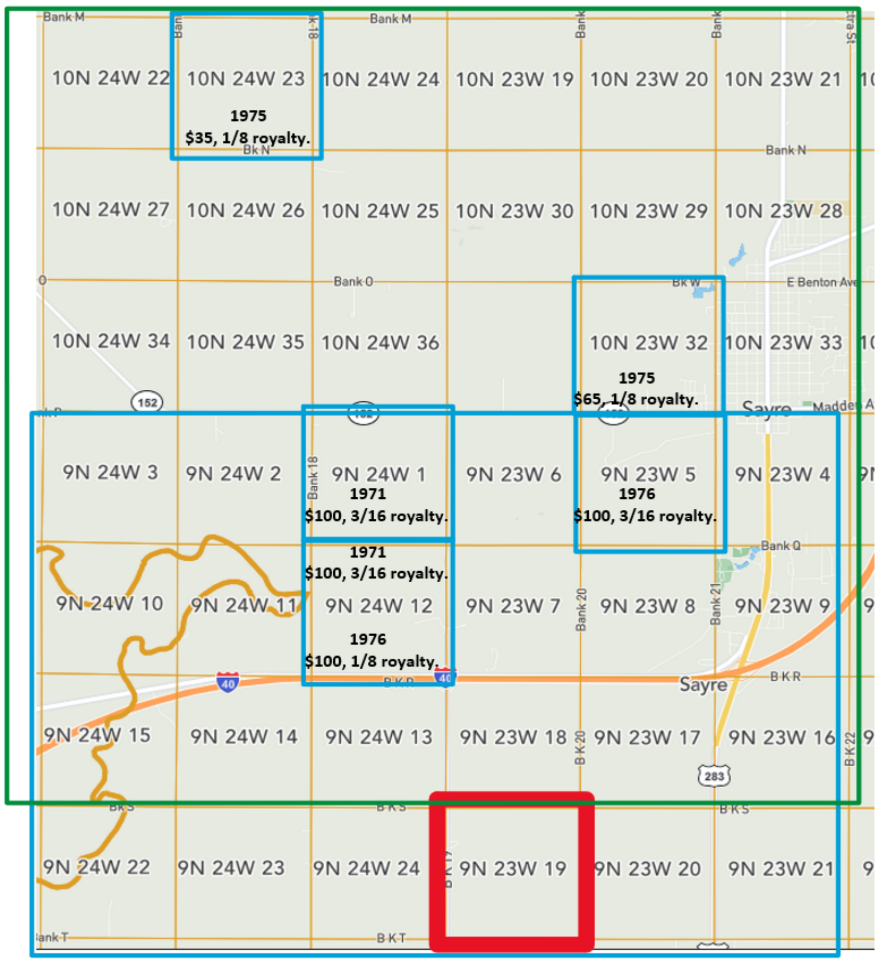
97. *Id.* Findings ¶ 7.

98. *Id.* Findings ¶ 9.

99. *Id.* Findings ¶ 12.

12) at $100 dollars each were gathered from testimony given by Coogan and another witness at the hearing.[100]

Figure 1.[101]



Using those $100 leases as evidence, Coogan and the other witness testified that the fair-market value should be set at $100 per acre with a 3/16

100. *Id.* Findings ¶¶ 8, 10.
101. The plain image of the plat map with section, township, and range was captured from acrevalue.com and the boxes, dates, and values were added by the author of this article in OneNote to help visualize the proximity of the sections to each other.

royalty.[102] After "taking into account all the facts, circumstances and evidence," the OCC settled on a $35 fair-market value with a 1/8 royalty.[103] The order walks through most of the testimony pertaining to fair-market value, but not much reasoning can be deduced from it. One thing the OCC does mention in its findings is that Coogan, the other witness, and the farmer testified to having no knowledge of specific leases in "the surrounding sections, with Section 19 being in the center."[104] This shows that the OCC did not truly consider anything outside of the surrounding nine sections, and if they did, they did not give them much weight.

3. The OCC's Authority to Exclude Certain Evidence

The Oklahoma Supreme Court has ruled that it is within the OCC's delegated powers to make decisions as to what is indicative of value. In 1981, the Oklahoma Supreme Court said that the OCC has broad discretion in determining what is just and reasonable compensation to mineral owners.[105] The Court points to Article 9 Section 20 of the Oklahoma Constitution, which says that any OCC proceeding appealed to the Supreme Court of Oklahoma will only be reviewed to determine whether the findings and conclusions of the OCC are sustained by law and substantial evidence.[106] In other words, the Oklahoma Supreme Court justices are supposed to affirm if there is evidence that has substance and relevance that could lead the OCC to rule the way they did, even if reasonable minds could differ.[107]

The Oklahoma Supreme Court, then, gives a lot of deference to the OCC. Even if there is conflicting evidence as to the value of an oil and gas lease, the Court is "not privileged to weigh the evidence upon review."[108] That evidence should be "more than a scintilla; possessing something of substance and of relevant consequence carrying with it a fitness to induce conviction but remains such that reasonable persons may fairly differ on the point of establishing the case."[109]

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102. OCC Cause CD No. 46342, Findings ¶¶ 8, 10.
103. *Id.* Findings ¶ 14.
104. *Id.* Findings ¶¶ 9, 11, 13.
105. Miller, 1981 OK 55, ¶ 5.
106. O.K. CONST. art. 9, § 20.
107. Miller, 1981 OK 55, ¶ 6.
108. Texas Oil & Gas Corp. v. Rein, 1974 OK 9, ¶ 12, 534 P.2d 1280, 1281.
109. Sundown Energy, L.P. v. Harding & Shelton, Inc., 2010 OK 88, ¶ 9, 245 P.3d 1226, 1230.

Fred Coogan and Grady Wallace were not happy that the OCC gave their interests a $35 fair-market value. They were so unhappy that they took the OCC to the Oklahoma Supreme Court. They appealed the pooling order, arguing that the $35 figure was not the true value of their lease. They argued the admissible evidence relating to fair-market value established it to be $100.[110] The Oklahoma Supreme Court ruled that the OCC's decision was supported by substantial evidence because the $35 leases in Section 19 introduced as testimony at the hearing were open market transactions.[111] The Court took Coogan and Wallace's argument to be that the OCC was wrong in using the $35 leases, and it focused on whether those leases were admissible.[112] The Court never differentiated between the $35 leases and the $100 leases as far as admissibility goes.[113] It mentioned that, at the hearing, "the only testimony given . . . to establish fair market value of leases . . . is value determined by looking at comparable sales, both in that Section and removed from it."[114] The Court didn't exclude the $100 leases in that determination, even though they are not in the nine sections surrounding Section 19. The Court went on to say that Coogan and Wallace's contention that the prices paid for leases in the area were not admissible could not be true because, if it were, "there would be no admissible evidence in the record before us as that is the basis upon which all the recorded testimony rests."[115] This means that all leases, not only the nine surrounding Section 19, are admissible.

Leases held by the state are also unnecessarily excluded from evidence. One possible reason why state leases are not considered at hearings is found in a 1981 Oklahoma Supreme Court Case. In *Miller v. Corporation Commission*, the appellant challenged the OCC's award of $75 per acre in a lease bonus and a 1/8 royalty. There was a nearby state lease that paid a bonus of $101.88 and a royalty of 1/6.[116] In a 5-4 decision, the Oklahoma Supreme Court held it was permissible for the OCC to exclude evidence of a state lease because the statutorily mandated, sealed-bid process for leasing state-owned minerals did not represent a sale in the open market.[117] As mentioned before, the fair market value of a pooled interest needs to be at a

110. Coogan v. Arkla Exploration Co., 1979 OK 6, ¶ 1, 589 P.2d 1061.
111. *Id.* ¶ 12.
112. *Id.* ¶ 10.
113. *Id.*
114. *Id.* ¶ 9.
115. *Id.* ¶ 10.
116. Miller, 1981 OK 55, ¶ 3.
117. *Id.* ¶ 13.

level where the interest can be bought and sold freely on the open market.[118] The four dissenting justices argued state leases should be admissible in a pooling hearing because they do, indeed, represent a fair market value.[119] The statutorily mandated sealed-bid process leases state-owned land to an oil and gas company by requiring bidding parties to send their bid in a sealed envelope. No other party knows their bid until the seller opens all envelopes at once and takes the highest bid.[120] It is understandable why this might not represent a usual fair market scenario because no one knows what anyone else is bidding.

But as the dissenters argued, this process is designed to allow the state to take advantage of all the benefits the open market has to offer.[121] The statute itself even requires the OCC to "provide any other notice of oil and gas lease sales to all interested parties by any means it determines is needed to attract the best competition."[122] Further, the state can reject any or all bids that they receive,[123] which would lend credence to the idea that this is an open market strategy. The only time the state will likely reject a bid is when it does not believe it is getting fair compensation.

But most importantly, the majority never explicitly prohibited state leases at pooling hearings. The Supreme Court was only concerned with the question of whether the OCC could exclude that evidence.[124] The majority emphasized the appellant didn't argue the sealed-bid price in the lower court, and that it didn't show enough evidence as to why it should be indicative of fair market value.[125] This leaves open the possibility that the decision might have come out differently had the appellant argued for using the state lease as a basis for the fair market value at the lower court. This case cannot be the basis for claiming that state leases are inadmissible at pooling hearings.

Despite the shortcomings mentioned above, the OCC commonly points to the *Coogan* to support its actions.[126] The OCC notes that the supreme

118. *Id.* ¶ 8.
119. *Id.* ¶ 5. (Simms, J. dissenting).
120. 64 O.S. § 1063 (OSCN 2021).
121. Miller, 1981 OK 55, ¶ 3. (Simms, J. dissenting).
122. 64 O.S. § 1063 (OSCN 2021).
123. *Id*.
124. Miller, 1981 OK 55, ¶ 6.
125. *Id.* ¶ 13.
126. *See* OCC Cause CD No. 201902430, 12, https://imaging.occ.ok.gov/AP/CaseFiles/occ30306480.pdf, *see also* OCC Cause CD No. 201904209, 15, https://imaging.occ.ok.gov/AP/CaseFiles/occ30364755.pdf, *see also* OCC Cause CD No. 201901680, 16, https://imaging.occ.ok.gov/AP/CaseFiles/occ30293071.pdf (all discussing the Coogan case).

court case says that fair market value is to be determined "by evidence of transactions involving similar property in the 'vicinity' consummated 'within a close time period.'"[127] There are two key terms that must be interpreted here.

First, the OCC interprets the term "vicinity" using a law review article written by a former commissioner of the OCC, Charles Nesbitt.[128] In that article, Nesbitt "expressed his *opinion* that 'scant consideration' is given to any transactions outside an area that involved the subject section and its eight adjoining sections."[129] In other words, limiting the term "vicinity" to mean only the 9 surrounding sections is not mandated by the Oklahoma Supreme Court. The only cases used to vaguely support this contention say that distance "should be considered," and a lease is not sufficiently comparable if it is "too distant."[130] The opinion of a former commissioner is the only thing binding the OCC to follow this practice. Second, the OCC, with no authority from the Oklahoma Supreme Court, interprets the phrase "within a close period of time" to mean transactions "consummated within a year of the hearing.[131]

Walking through a scenario will help to illustrate why these limits don't always lead to a fair value and why they are hard to reconcile with the Supreme Court's definition of fair market value. Suppose an operator wants to acquire two leases so that he can drill an oil well. One lease is owned by a vertical producer, the other is owned by a landowner. The operator secured the landowner's lease because the landowner does not know what the going rate for oil and gas leases is, so he leased it for $1,000 per acre and a 1/8 royalty. The operator then goes to the vertical producer and offers the same deal, but the vertical producer rejects it. He rejects it because he secured his lease 18 months ago for $5,000 per acre and a 1/5 royalty, a much higher value than what he is currently being offered. That vertical producer also knows of several other producers in the industry who have recently gotten identical deals just a few miles away. He also has suspicions that even more lucrative lease deals have been traded between operators in

127. OCC Cause CD No. 201902430, 12, https://imaging.occ.ok.gov/AP/CaseFiles/occ30306480.pdf.

128. *Id.* at 13.

129. *Id.* at 13 (emphasis added), *see* Nesbitt, *supra* note 17 at 650.

130. OCC Cause CD No. 201902430, 12, https://imaging.occ.ok.gov/AP/CaseFiles/occ30306480.pdf (referring to Miller v. Corp. Comm'n, 635 P.2d 1006 (Okla. 1981) and BP America Production Company v. Lo Yare, *L.P.*, 2008 WL 9876064, 2008 OK CIV APP).

131. OCC Cause CD No. 201901680, 16, https://imaging.occ.ok.gov/AP/CaseFiles/occ30293071.pdf.

multi-unit trades in the area. But because the only lease allowed as evidence in this situation is the $1,000 lease, that's all that will be considered at a forced pooling hearing.

Though the scenario above follows the OCC's guidelines, it is difficult to reconcile this scenario with the standards for what constitutes a fair market value laid out by the Oklahoma Supreme Court in *Miller*. The value to be determined at pooling hearings should be "extracted from transactions under usual and ordinary circumstances which occurred in a free and open market." The Oklahoma Supreme Court says the sale of an interest, "when taken by eminent domain, is the most common example of a sale not made in the open market. It is said to be affected by special circumstances which do not exist in open market transactions." The landowners $1,000 is a perfect example of a sale "affected by special circumstances which do not exist in open market transactions." In the multi-unit trades, there is probably no threat of forced pooling looming in the back of the parties' minds when they are negotiating a deal. Similarly, they probably freely discussed and used evidence of trades miles away without worry. Finally, because a "pooling order cannot be used as evidence of Fair Market Value,"[132] neither should a negotiation that, if it not had been reached, would have been pooled anyway.

4. Issues Beyond Fair Market Value

The process of determining a fair value is already questionable, but what the OCC then does with that fair value is even worse. The OCC takes that fair value and sets an arbitrary bright line cutoff so that anything below its idea of a fair market value is worth practically nothing. In most situations, the value of a lease's cash bonus tapers down depending on how much working interest is involved. For example, take an order from 2020. The OCC gives the parties being pooled different cash bonus options to accept. These values are $4,000 for 7/8 working interest, $3,250 for a 13/16 working interest, $3,000 for 4/5, and $1,500 for 3/4.[133] If an owner comes in with anything less than seventy-five percent working interest, they can either participate or "accept the total sum of $1.00 per net mineral acre in full consideration of their entire interest in the unit."[134] For mineral owners who currently have 100% of their mineral rights, this might not be a big

132. OCC Cause CD No. 201904209, 15, https://imaging.occ.ok.gov/AP/CaseFiles/occ30364755.pdf.

133. OCC Cause CD No. 201802232, https://imaging.occ.ok.gov/AP/Orders/occ30335575.pdf

134. *Id.*

deal because they can simply offer seventy-five percent or more. But for an independent producer who has already secured a lease with anything less than seventy-five percent working interest, there is simply nothing they can do. For a deal involving a 160-acre mineral interest, a producer offering a seventy-five percent working interest will receive a cash bonus of $240,000, while a producer offering 74.9% will receive $160 in exchange for their entire interest in the unit.

The OCC determines that cutoff for working interest percentage on a case-by-case basis. This depends on other "fair market" leases that are allowed in as evidence on any given pooling application. Another example from 2020 shows just that.[135] In that order, the parties being pooled could accept a bonus of $200 per acre, plus they could retain a royalty of 1/16 (6.25%) in exchange for 13/16 working interest.[136] Their second option, besides participation, was to accept no cash bonus, but retain a 7.5% royalty for themselves in exchange for 4/5 working interest. But if they had anything less than an 80% working interest to offer could only receive a $1 per acre cash bonus with no royalty at all.

Again, it is easy to see how unfair this bright line cutoff is. There is no way for a vertical producer to know what the bright line rule might be when they are initially negotiating for a lease with the intention of drilling it themselves. A small independent producer might make it a habit of making deals where they get 75% working interest and the original owner retains 25%. If they get pooled and the OCC sets that bright line "market value" cutoff at 80%, the vertical producer has absolutely no negotiating power and they must accept the $1 nominal value because they only have 75% to work with. They cannot retroactively go back and change the original terms. With the 80% cutoff scheme mentioned above, 81.25% (13/16) working interest will give someone on a 160-acre mineral interest a bonus of $32,000 plus a royalty interest so that they continue to be compensated with a percentage of the proceeds of production. But if they have a 79.9% interest to offer, by no fault of their own, but simply because that is all they have to work with, they are left with $160 compensation, no royalty. This is all because they could not offer at or above the cutoff value determined by the OCC.

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135. OCC Cause CD No. 201903745, 3. https://imaging.occ.ok.gov/AP/Orders/occ30320335.pdf.

136. 2/16 of the interest would remain with the original mineral owner, with the 13/16 working interest and the 1/16 overriding royalty we have 100% of the interest accounted for.

The OCC says that any interest below this bright line level is "burdened beyond fair market value."[137] To briefly review, consider a case where the OCC puts a price tag of a $4,000 per acre bonus on an 87.5% (7/8) working interest, $3,250 for 81.25% (13/16), $3,000 for 80%, $1,500 for 75%, and $1 for 74.9% and below. If this pricing scheme is analyzed in light of Oklahoma's own definition of "fair market value," the flaws are hard to miss. The Oklahoma Supreme Court defines the fair market value as "the level at which this interest can be sold, on open-market negotiations, by an owner willing, but not obliged, to sell to a buyer willing, but not obliged, to buy."[138] Going back to the car example from the Introduction, no one would knock down the value of a car from $40,000 to $200 because the car is one mile over a certain threshold on the odometer. It is equally hard to imagine any scenario where an owner is willing to sell a 75% working interest in a 160 acre for $240,000, and at the same time, be just as willing to sell a 74.9% working interest in that same 160 acres for $160.

IV. Be More Like Texas

A. These Changes Will Not Compromise Oklahoma's Legislative Intent

Oklahoma and Texas have two different goals when it comes to forced pooling. Texas wants to encourage voluntary pooling plain and simple, and Oklahoma wants to protect correlative rights, prevent drilling of unnecessary wells, and promote oil and gas production.[139] But these two policy concerns can work in tandem. It is unlikely that producers will shut down operation just because they can't force pool as easily as they once could. Producers are still going to produce oil and gas. Creating a more free-market approach to pooling interests would help transfer some of the wealth being accumulated back to the pockets of landowners and small vertical producers.[140] This furthers Oklahoma's intent to protect correlative rights, ensuring that no landowner can be forced to pool without a fair and reasonable offer being made. Oklahoma should not be so desperate to produce oil and gas that it allows producers to pay non-consenting owners

137. OCC Cause CD No. 201903745, *supra* note 135.

138. Miller, 1981 OK 55, ¶ 8.

139. Bill summary for SB 867, http://webserver1.lsb.state.ok.us/cf_pdf/2017-18%20SUPPORT%20DOCUMENTS/BILLSUM/House/SB867%20ENGR%20BILLSUM.PDF (Amendments were made to certain exploration statutes in 2017 with the primary purpose of increasing oil and gas production, estimated impact on gross production tax collections would be around $18 million).

140. Warren, *supra* note 91.

hardly anything. These changes will still allow oil and gas to be produced. It's not like a non-consenting owner can say no and prevent exploration. They still cannot turn down an offer that is genuinely "fair and reasonable."

B. Fair Market Value Must Be Addressed

The biggest change that needs to be made is the enforcement of showing a bona fide effort to reach an agreement. Without this change, it won't matter if Oklahoma keeps the options-given approach or adopts a risk-penalty approach. If a pooling order continues to be this easy and automatic, the end result will be inevitable. The OCC must enforce the bona fide effort requirement and make parties show that efforts have been made to reach a fair deal.

Part of showing a bona fide effort to reach a fair deal means that the OCC also needs to get a better grasp on what a fair deal looks like. A stronger enforcement of showing a bona fide effort will not make a difference if the applicants just have to show that an offer was made. It needs to be a fair and reasonable offer. In Texas, the offer must take into consideration all the relevant facts that existed at the time of the offer and that "would be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties."[141] Surely, state leases, Indian leases, leases outside the surrounding nine sections, and leases that have been traded between big oil production companies would be information that a reasonable person would find important if they were negotiating a voluntary pooling agreement.

Once Oklahoma has a better idea of what fair values look like, then enforcement of the bona fide effort requirement will start to do its job of weeding out pooling applicants who have not given a fair offer. Like Texas, Oklahoma will then begin to see more voluntary pooling agreements happening. When this happens, then the result of a forced pooling will start to make a difference in the decisions being made by parties both applying, and subject to, a forced pooling order. If non-consenting owners know that there is a risk-penalty waiting for them if they choose not to accept a fair and reasonable offer, they might think twice about turning that offer down. Similarly, the non-consenting owners would not have to worry about a potential unfair deal being given to them under Oklahoma's current options-given approach if Oklahoma would ensure that the applicant first makes a fair and reasonable offer on their own. But of course, this is a bit contradictory because the fair value determined in the bona fide effort to

141. Carson v. R.R. Comm'n of Tex., 669 S.W.2d 315, 318 (Tex. 1984).

reach an agreement would ideally be the same as one handed down at the pooling hearing. Therefore, the best approach would be for Oklahoma to enforce its bona-fide requirement, expand its valuation method to better resemble open-market negotiations, and then add a risk-penalty approach to the back end of the process.

Currently, because big oil companies know that at a pooling hearing they will likely have to pay an owner an amount that does not reflect the true market value, they are much more inclined to file a pooling application, rather than negotiate with owners. Taken together, not having to do any work to show a bona fide effort was made to reach an agreement and knowledge that they will get a better deal through a pooling order, there is no incentive for big oil companies to do anything but file pooling applications. But with these changes in place, the incentive for applicants to voluntarily pool comes from the strict enforcement of the bona fide effort requirement, and the incentive for non-consenting owners comes from the risk-penalty approach. Taken together, this is the best way to encourage as much voluntary pooling as possible.

V. The Path Forward

If there is going to be a change in the way that forced pooling is handled in Oklahoma, the OCC is going to have to make it happen. In this final section, I will begin first with a discussion on why the Oklahoma Supreme Court is not a realistic option. Second, I will discuss how legislative action can help efforts to change forced pooling but ultimately will not be enough by itself. Finally, I will end by showing why the OCC has the last say on any changes to be made in this area of law.

A. Court Is Not a Realistic Option

With the great discretion the OCC is afforded, a heavy burden is put on anyone trying to change the way forced pooling operates by way of the Oklahoma Supreme Court. Then there is the issue of finding someone with the time and resources to see litigation through. In most scenarios it is better for an independent vertical producer to accept the pooling order and take the unfair deal now. Trying to litigate, on the other hand, could tie up the independent producer's resources for the foreseeable future, depending on how long litigation lasts. There is also no guarantee that litigation will be successful. One reason, among others, is that the big horizontal drilling companies on the other side of litigation could drag things out indefinitely, as they would probably try to just wait until the small producer runs out of money. Even if litigation were to ever come to an end, there is no reason for a small producer to hold out hope considering the deference the OCC has been given.

When balancing those factors, a small producer likely will not put their livelihood on the line and will continue to operate knowing the truths of forced pooling are just an inevitable part of the industry that they will have to deal with. But hoping to avoid forced pooling, like a farmer hopes to avoid a drought, should not be the end of this discussion. Forced pooling can be fixed, even if that means turning to the legislature.

B. Legislative Changes Alone Are Not Enough

There are three legislative changes that can be made to § 87.1 that could have a large impact on the number of pooling applications that get through the door. First, modify the statute to make pooling orders effective for only the initial well, rather than the entire spacing unit. Second, change the requirement from separate land "or" separate interests to separate land "and" separate interests. And third, change Oklahoma's options-given approach to a risk-penalty approach.

First, the statute currently says that, where owners have not agreed to pool and where one owner has drilled or proposes to drill a well, the Commission shall "require such owners to pool and develop their lands in the spacing unit as a unit."[142] Changing the phrase "in the spacing unit as a unit," to "in the well," would fix this issue. If the pooling order only applied to one well, then the issue of the non-consenting owners having to take a gamble at the outset would be fixed.[143] If the well turns out to be successful, it would be fair to have the owners who were pooled to be able to opt in after seeing the success. There could be some sort of penalty or buy in required as well so that they don't simply get to avoid the entire risk of the initial well, but instead have to compensate the owners who did take that risk before they are allowed to then participate. But all of this could be discussed and incorporated into the risk-penalty approach if it were adopted.

The second change would require that not only there be separate interests involved, but also that there be multiple owners of the actual land.[144] This only requires one word to be changed from § 87.1(e). The new statute would then eliminate pooling as an option in those scenarios that involve

142. 52 O.S. § 87.1(e) (OSCN 2021).

143. *See supra* Section II(B).

144. *See supra* Section II(C) (example of co-tenants on one farmer's land excluded from pooling authority in Texas, but not Oklahoma).

one landowner, but multiple interest owners. The new statute would simply read, "When two or more separately owned tracts of land are embraced within an established spacing unit, **and** where there are undivided interests separately owned . . ." the Commission shall pool their interests.

The last big change that can come from legislation is the change from an options-given approach to a risk-penalty approach. As I discussed earlier,[145] this will incentivize non-consenting owners to come to a voluntary agreement rather than waiting out a pooling order to see the options they might get. But this risk-penalty approach only works if the OCC does its part by ensuring a more realistic fair-value is determined. Without the OCC's help, this last change would likely only make things worse, leading to automatic pooling and automatic penalties.

C. Nothing Changes Unless "Industry Custom and Practice in the Profession" Changes

The easiest and most realistic way for forced pooling to change in Oklahoma is for the OCC to make it happen. This requires nothing more than a revision of the way that things are currently done, but that is much easier said than done. There are no binding standards as to why certain evidence can or cannot be excluded, even though the OCC uses Oklahoma Supreme Court cases to justify some of their practices, as I mentioned earlier.[146] But overall, the discretion given to the OCC by the Oklahoma Supreme Court will allow these changes to be made.

If these new methods of valuation are challenged at the Oklahoma Supreme Court, they will likely fail because of the deference given to the OCC. Even if there is conflicting evidence as to the value of an oil and gas lease—as there surely will be by any party who challenges the OCC in court—the Oklahoma Supreme Court is "not privileged to weigh the evidence upon review."[147] Any OCC order will only be reviewed to determine whether the findings and conclusions of the OCC are sustained by law and substantial evidence.[148] If the OCC were to find a fair market value using leases outside the surrounding nine sections, state leases, multi-unit trades, or leases older than a year, it would be hard to find that these leases were not indicative of fair market value. As long as they were negotiated between a willing buyer and a willing seller. And of course, the Oklahoma Supreme Court will affirm if there is evidence that has substance

145. *See supra* Section IV.
146. *Supra* Section III(C)(ii).
147. Texas Oil & Gas Corp. v. Rein, 1974 OK 9, ¶ 12, 534 P.2d 1280, 1281.
148. O.K. CONST. art. 9, § 20.

and relevance that could lead the OCC to rule the way they did, even if reasonable minds could differ.[149]

Possibly the greatest hurdle to overcome is the OCC's reliance on its own custom and traditions. An Oklahoma Civil Court of Appeals case permitted the OCC to limit evidentiary leases geographically, and in time, because these practices were "customary industry custom and practice in the profession."[150] The case addressed both the limit on the size of the area to be reviewed, and the time frame on leases to be considered when making a fair value determination.[151] The OCC regularly uses this case as support for limiting leases at hearing.[152] As I have already shown, there is no binding authority forcing the OCC to adhere to these methods of valuation when it comes to the geographic area to be considered, the timeframe, and state lease[153] exclusion. The Supreme Court simply held that it was within the OCC's discretion.[154]

The Civil Appeals case here, though, gives the OCC a way to defend any of their practices, specifically the exclusion of certain evidence not within the surrounding nine sections and leases older than one year. But the OCC can use this rationale to justify the other issues I've discussed as well, including the practice of valuing lease bonuses at only $1 per acre if they fall below the minimum working interest cutoff[155] and the practice of excluding multi-unit[156] leases. Because these practices have been used for so long, any one of them will most certainly be found to fall within the "customary industry custom and practice in the profession."

Although the OCC is not a court of general jurisdiction, looking to the Oklahoma Supreme Court criteria for going against precedent can help determine if the OCC will go against their standard practices anytime soon or not. The Oklahoma Supreme Court says that a substantial departure from precedent can only be justified based on an unsatisfactory experience with

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149. Miller, 1981 OK 55, ¶ 6.

150. BP Am. Prod. Co. v. Lo Yare, L.P., No. 104,680, 2008 WL 9876064, at *4 (Okla. Civ. App. July 11, 2008).

151. BP Am. Prod. Co., No. 104,680, 2008 WL 9876064, at *5.

152. *See* OCC Cause CD No. 201902430, 12, https://imaging.occ.ok.gov/AP/CaseFiles/occ30306480.pdf, *see also* OCC Cause CD No. 201904209, 15, https://imaging.occ.ok.gov/AP/CaseFiles/occ30364755.pdf, *see also* OCC Cause CD No. 201901680, 16, https://imaging.occ.ok.gov/AP/CaseFiles/occ30293071.pdf.

153. *See supra* Section III(C)(ii).

154. Wakefield, 1957 OK 10, ¶ 11.

155. *See supra* Section III(C)(ii).

156. *See* OCC Cause CD No 201904209, 6, https://imaging.occ.ok.gov/AP/CaseFiles/occ30364755.pdf.

the application of the precedent.[157] Including more evidence would be a much more appropriate valuation method in light of the *Miller* court's definition of fair market value. Knowing this and having to enforce the current practices of valuation just because that is the way it has been done before must be an unsatisfactory experience for someone.

Finally, administrative agencies are free to change their mind when it comes to statutory construction, and the courts are to only review the administrative decision, and not the agencies change in construction.[158] Similarly, the OCC should be able to change the way they enforce a bona fide effort, and they should be able to change the way they value leases, all with no flak from the Oklahoma Supreme Court.

The OCC has the power to change, and it is no secret that they are free from any binding Oklahoma Supreme Court precedent. If any change, by the OCC's own effort, were to happen, it would have happened already. Because it has gone so long with these same standards, and because it continues to rely on the industry custom and practice in the profession, there is no sign that anything is going to change unless the OCC is provoked from outside influences.

VI. Conclusion

Oklahoma needs to re-work its forced pooling scheme so that non-consenting owners stop getting forced to pool for unfair lease values. The biggest change that needs to be made involves stopping the automatic nature of forced pooling that currently exists. The OCC can do this by enforcing and requiring parties to show a bona fide effort was made to reach an agreement prior to the pooling application. For the bona fide effort to have any bite, the OCC needs to re-evaluate the way it determines fair market value. Only when applicants believe that a true, fair market value will be determined at a pooling hearing will they be incentivized to come to a voluntary agreement before resorting to forced pooling. Add to that a risk-penalty approach and non-consenting owners will also be more incentivized to come to an agreement and avoid forced pooling. Only then will pooling in the oil and gas industry begin to operate like an open market, where lease values are determined by "open-market negotiations, by an owner willing, but not obliged, to sell to a buyer willing, but not obliged, to buy."[159]

157. Rogers v. Higgins, 1993 OK 45, 871 P.2d 398, 422 (Summers, J. dissenting, citing Phillips v. Oklahoma Tax Comm'n, 1978 OK 34, 577 P.2d 1278, 1286).

158. N.L.R.B. v. Viola Indus.-Elevator Div., Inc., 979 F.2d 1384, 1391 (10th Cir. 1992).

159. Miller, 1981 OK 55, ¶ 8.